



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

October 19, 2010

MEMORANDUM

To: The Commission

Through: Alec Palmor
Acting Staff Director

From: Patricia Carmona *PC*
Chief Compliance Officer

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Assistant Staff Director
Audit Division

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Audit Manager

By: Jim Miller *JM*
Lead Auditor

Subject: Audit Division Recommendation Memorandum on Kansas Republican Party
(A08-02)

Pursuant to Commission Directive No. 70 (FEC Directive on Processing Audit Reports), the Audit Division recommends the Commission approve the findings as presented in the Draft Final Audit Report (DFAR). The Kansas Republican Party declined the opportunity to have a hearing. The Office of General Counsel has reviewed this memorandum and concurs with the recommendation.

Finding 3., "Payment of Federal Activity Out of Non-federal Accounts" has been modified. No sample was provided for a mailer to allow a determination if it promoted, supported, opposed or attacked a clearly identified candidate. As such, that expenditure has been removed from the category "Payment and Disclosure of Non-Allocable Federal Election Activity" and placed in the category "Payment and Disclosure of Printed Materials." The Kansas Republican Party is aware of this modification and has been given an opportunity to respond in writing and/or request an audit hearing, which it declined and stated it agreed with the proposed modification.

The Kansas Republican Party was audited once before for the period January 1, 1976, through March 31, 1978. A summary of the report is at Attachment 1.

If this report is approved, the DFAR will be revised accordingly and circulated on a 72 hour no objection basis as a "Proposed Final Audit Report" within 30 days of the Commission's vote.

Should an objection be received, Directive No. 70 states that the report be placed on the next regularly scheduled open session agenda.

Documents related to this audit report can also be viewed on Voting Ballot Matters. Should you have any questions, please contact Jim Miller or Alex Boniewicz at 694-1200.

Attachments:

Attachment 1- Previous audit

Draft Final Audit Report on the Kansas Republican Party

cc: Office of General Counsel



Draft Final Audit Report of the Audit Division on the Kansas Republican Party

January 1, 2007 – December 31, 2008

Why the Audit Was Done

Federal law permits the Commission to conduct audits and field investigations of any political committee that is required to file reports under the Federal Election Campaign Act (the Act). The Commission generally conducts such audits when a committee appears not to have met the threshold requirements for substantial compliance with the Act. The audit determines whether the committee complied with the limitations, prohibitions and disclosure requirements of the Act.

Future Action

The Commission may initiate an enforcement action, at a later time, with respect to any of the matters discussed in this report.

About the Committee (p. 2)

The Kansas Republican Party is a state party committee headquartered in Topeka, Kansas. For more information, see the chart on the Committee Organization, p. 2.

Financial Activity (p. 2)

• Receipts

○ Contributions from Individuals	\$ 645,470
○ Contributions from Other Political Committees	50,877
○ Transfers from Affiliated/Other Party Committees	45,475
○ Transfers from Non-federal Account	22,239
○ All Other Receipts	14,774
Total Receipts	\$ 778,835

Disbursements

○ Operating Disbursements	\$ 781,933
○ All Other Disbursements	6,485
Total Disbursements	\$ 788,418

Findings and Recommendations (p. 3)

- Misstatement of Financial Activity (Finding 1)
- Receipt of Apparent Prohibited Contributions (Finding 2)
- Payment of Federal Activity Out of Non-federal Accounts (Finding 3)

¹ 2 U.S.C. §438(b).

Draft Final Audit Report of the Audit Division on the Kansas Republican Party

January 1, 2007 – December 31, 2008

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Part I

Background

Authority for Audit

This report is based on an audit of the Kansas Republican Party (KRP), undertaken by the Audit Division of the Federal Election Commission (the Commission) in accordance with the Federal Election Campaign Act of 1971, as amended (the Act). The Audit Division conducted the audit pursuant to 2 U.S.C. §438(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 2 U.S.C. §434. Prior to conducting any audit under this subsection, the Commission must perform an internal review of reports filed by selected committees to determine if the reports filed by a particular committee meet the threshold requirements for substantial compliance with the Act. 2 U.S.C. §438(b).

Scope of Audit

Following Commission approved procedures, the Audit staff evaluated various risk factors and, as a result, this audit examined:

1. The disclosure of disbursements, debts and obligations.
2. The disclosure of expenses allocated between federal and non federal accounts.
3. The disclosure of individual contributors' occupation and name of employer.
4. The receipt of contributions from prohibited sources.
5. The consistency between reported figures and bank records.
6. The completeness of records.
7. Other committee operations necessary to the review.

Limitations

In maintaining its disbursement records, KRP satisfied the minimum recordkeeping requirements of 11 C.F.R. §102.9; however, the Audit staff's testing of disbursements was limited by the lack of external documentation, such as invoices. This lack of third party records limited the testing for recordkeeping and the proper reporting of debts and obligations, as well as the adequacy of disclosure of information, such as payee, address and purpose for disbursements.

Part II

Overview of Committee

Committee Organization

Important Dates	Kansas Republican Party
• Date of Registration	March 15, 1979
• Audit Coverage	January 1, 2007 - December 31, 2008
Headquarters	Topeka, Kansas
Bank Information	
• Bank Depositories	One
• Bank Accounts	Six Federal and Four Non-federal
Treasurer	
• Treasurer When Audit Was Conducted	Steve Fitzgerald
• Treasurer During Period Covered by Audit	Emmille Mitchell (thru 2/04/07) David Thorne (2/05/07 thru 12/17/07) Morey Sullivan (12/18/07 thru 2/17/09)
Management Information	
• Attended Commission Campaign Finance Seminar	No
• Used Commonly Available Campaign Management Software Package	Yes
• Who Handled Accounting and Recordkeeping Tasks	Paid staff

Overview of Financial Activity (Audited Amounts)

Cash on hand @ January 1, 2007	\$ 14,426
Receipts	
○ Contributions from Individuals	\$ 645,470
○ Contributions from Other Political Committees	50,877
○ Transfers from Affiliated/Other Party Committees	45,475
○ Transfers from Non-federal Account	22,239
○ All Other Receipts	14,774
Total Receipts	\$ 778,835
Disbursements	
○ Operating Disbursements	\$ 781,933
○ All Other Disbursements	6,485
Total Disbursements	\$ 788,418
Cash on hand @ December 31, 2008	\$ 4,843

Part III Summaries

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

A comparison of KRP's reported figures to bank records revealed a misstatement of receipts, disbursements and cash-on-hand in both 2007 and 2008. For 2007, KRP overstated beginning cash on hand by \$4,628, overstated receipts by \$11,885, understated disbursements by \$11,370 and overstated ending cash-on-hand by \$27,883. In 2008, receipts were understated by \$111,149, disbursements understated by \$176,956 and the ending cash-on-hand was overstated by \$93,690. In response to the interim audit report recommendation, KRP amended its reports to materially correct the misstatements noted above. (For more detail, see p. 4)

Finding 2. Receipt of Apparent Prohibited Contributions

Based on a review of contributions received by KRP, the Audit staff identified four contributions totaling \$52,498 which appear to be from prohibited sources. In response to the interim audit report, KRP indicated it had transferred \$15,000 from its federal to its non-federal account. Citing insufficient funds, KRP amended its most recent report to disclose a debt to its non-federal account for the remaining prohibited contributions of \$37,498. (For more detail, see p. 6)

Finding 3. Payment of Federal Activity Out of Non-federal Accounts

KRP appeared to have improperly made payments totaling \$104,859 from its non-federal accounts for federal expenses. In response to the interim audit report, KRP amended its reports to disclose these disbursements paid from its non-federal account for federal/shared expenses. (For more detail, see p. 9)

Part IV

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

Summary

A comparison of KRP's reported figures to bank records revealed a misstatement of receipts, disbursements and cash-on-hand in both 2007 and 2008. For 2007, KRP overstated beginning cash on hand by \$4,628, overstated receipts by \$11,885, understated disbursements by \$11,370 and overstated ending cash-on-hand by \$27,883. In 2008, receipts were understated by \$111,149, disbursements understated by \$176,956 and the ending cash-on-hand was overstated by \$93,690. In response to the interim audit report recommendation, KRP amended its reports to materially correct the misstatements noted above.

Legal Standard

Contents of Reports. Each report must disclose:

- The amount of cash on hand at the beginning and end of the reporting period;
- The total amount of receipts for the reporting period and for the calendar year;
- The total amount of disbursements for the reporting period and for the calendar year; and
- Certain transactions that require itemization on Schedule A (Itemized Receipts) or Schedule B (Itemized Disbursements). 2 U.S.C. § 434(b)(1)(2), (3), (4) and (5).

Facts and Analysis

The Audit staff reconciled reported activity to bank records for calendar years 2007 and 2008. The following charts outline the discrepancies for the beginning cash balances, receipts, disbursements, and the ending cash balances for each year. Succeeding paragraphs address the reasons for the misstatements.

2007 Committee Activity			
	Reported	Bank Records	Discrepancy
Beginning Cash Balance @ January 1, 2007	\$19,054	\$14,426	\$4,628 Overstated
Receipts	\$184,566	\$172,681	\$11,885 Overstated
Disbursements	\$172,457	\$183,827	\$11,370 Understated
Ending Cash Balance @ December 31, 2007	\$31,163	\$3,280	\$27,883 Overstated

The beginning cash on hand was overstated by \$4,628 and is unexplained, but likely resulted from prior period discrepancies.

The overstatement of receipts was the result of the following:

• Contribution amount incorrectly reported (see details below)	\$ 8,220
• Reported non-federal caucus receipts in error	(25,000)
• Transfer of funds from non-federal not reported	2,599
• Unexplained difference	2,296
Net Overstatement of receipts	\$ (11,885)

The understatement of disbursements was the result of the following:

• Transfer to non-federal account not reported (see details below)	\$ 8,220
• Disbursements not reported	3,150
Understatement of disbursements	\$ 11,370

KRP received a \$15,000 contribution from an individual and deposited the funds to its federal account on October 24, 2007. KRP reported the amount of this contribution as \$6,780, which represented the \$10,000 contribution limit for individuals less \$3,220, the amount of contributions already received from the individual prior to October 24, 2007, thus understating receipts by \$8,220 (\$15,000-\$6,780). In addition, KRP transferred \$8,220, the excess portion of the contribution, from its federal account to its non-federal account on October 25, 2007, but did not include the disbursement on its 2007 November monthly report.

The \$27,883 overstatement of the closing cash on hand was the result of the misstatements described above.

In 2008, one of five accounts that KRP considered to be non-federal bank accounts had a significant number of transactions which appeared to be federal in nature. Nearly all receipts and expenditures related to attendance at the Republican National Convention. The Audit staff has included all activity from this account (the National Convention account) in reportable activity.

2008 Committee Activity			
	Reported	Bank Records	Discrepancy
Beginning Cash Balance @ January 1, 2008	\$31,163	\$3,280	\$27,883 Overstated
Receipts	\$495,005	\$606,154	\$111,149 Understated
Disbursements	\$427,635	\$604,591	\$176,956 Understated
Ending Cash Balance @ December 31, 2008	\$98,533	\$4,843	\$93,690 Overstated

The understatement of receipts resulted from the following:

• Receipts deposited into the National Convention account not reported	\$ 74,320
• Refund received from Paychex not reported	2,846

• Receipts deposited into various federal accounts not reported	25,822
• Permissible cash deposit for sale of yard signs not reported	13,236
• Reported non-federal caucus receipts in error	(10,000)
• Transfers from the non-federal account not reported	13,737
• Unexplained difference	(8,812)
Net Understatement of receipts	<u>\$ 111,149</u>

The \$74,320 in receipts deposited into the National Convention account included \$42,498 that represents three possible prohibited contributions which were used to defray the cost of hotel rooms, breakfasts for the delegates, and entertainment as discussed in Finding 2 below.

The understatement of disbursements resulted from the following:

• Transfers to the non-federal account not reported	\$ 5,500
• Disbursements from the National Convention account, as discussed above, not reported	105,243
• Other disbursements not reported	<u>66,213</u>
Understatement of disbursements	<u>\$ 176,956</u>

The majority of the \$105,243 disbursements from the National Convention account were used for convention lodging expenses and payroll costs.

The \$93,690 overstatement of the closing cash on hand was the result of the misstatements described above.

The Audit staff discussed the misstatements for 2007 and 2008 with a KRP representative during the exit conference and provided copies of relevant workpapers detailing the misstatements. The KRP representative stated that corrective amendments would be filed.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that KRP amend its reports to correct the misstatements for 2007 and 2008 as noted above. It was also recommended that KRP amend its most recently filed report to correct the cash on hand balance with an explanation that the change resulted from a prior period audit adjustment and that KRP reconcile the cash balance of its most recent report to identify any subsequent discrepancies that may impact the \$93,690 adjustment recommended by the Audit staff. In response to the interim audit report recommendation, KRP amended its reports to materially correct the misstatements noted above.

Finding 2. Receipt of Apparent Prohibited Contributions

Summary

Based on a review of contributions received by KRP, the Audit staff identified four contributions totaling \$52,498 which appear to be from prohibited sources. In response to the interim audit report, KRP indicated it had transferred \$15,000 from its federal to its non-federal account. Citing insufficient funds, KRP amended its most recent report to disclose a debt to its non-federal account for the remaining prohibited contributions of \$37,498.

Legal Standard

A. Receipt of Prohibited Corporate Contributions. Political committees may not accept contributions made from the general treasury funds of corporations. This prohibition applies to any type of corporation including a non-stock corporation, an incorporated membership organization, and an incorporated cooperative. 2 U.S.C. §441b.

B. Definition of Limited Liability Company. A limited liability company (LLC) is a business entity that is recognized as an LLC under the laws of the state in which it was established. 11 CFR §110.1(g)(1).

C. Application of Limits and Prohibitions to LLC Contributions. A contribution from an LLC is subject to contribution limits and prohibitions, depending on several factors, as explained below:

1. **LLC as Partnership.** The contribution is considered a contribution from a partnership if the LLC chooses to be treated as a partnership under Internal Revenue Service (IRS) tax rules, or if it makes no choice at all about its tax status. A contribution by a partnership is attributed to each partner by his or her share of the partnership profits. 11 CFR §110.1(e)(1) and (g)(2).
2. **LLC as Corporation.** The contribution is considered a corporate contribution—and is barred under the Act—if the LLC chooses to be treated as a corporation under IRS rules, or if its shares are traded publicly. 11 CFR §110.1(g)(3).
3. **LLC with Single Member.** The contribution is considered a contribution from a single individual if the LLC is a single-member LLC that has not chosen to be treated as a corporation under IRS rules. 11 CFR §110.1(g)(4).

D. Limited Liability Company's Responsibility to Notify Recipient Committee. At the time it makes a contribution, an LLC must notify the recipient committee:

- That it is eligible to make the contribution; and
- In the case of an LLC that considers itself a partnership (for tax purposes), how the contribution should be attributed among the LLC's members. 11 CFR §110.1(g)(5).

E. Questionable Contributions. If a committee receives a contribution that appears to be prohibited (questionable contribution), it must follow the procedures below:

1. Within 10 days after the treasurer receives the questionable contribution, the committee must either:
 - Return the contribution to the contributor without depositing it; or
 - Deposit the contribution (and follow the steps below). 11 CFR §103.3(b)(1).
2. If the committee deposits the questionable contribution, it may not spend the funds and must be prepared to refund them. It must therefore maintain sufficient funds to make the refunds or establish a separate account in a campaign depository for possibly illegal contributions. 11 CFR §103.3(b)(4).
3. The committee must keep a written record explaining why the contribution may be prohibited and must include this information when reporting the receipt of the contribution. 11 CFR §103.3(b)(5).
4. Within 30 days of the treasurer's receipt of the questionable contribution, the committee must make at least one written or oral request for evidence that the contribution is legal.

Evidence of legality includes, for example, a written statement from the contributor explaining why the contribution is legal or an oral explanation that is recorded by the committee in a memorandum. 11 CFR §103.3(b)(1).

5. Within these 30 days, the committee must either:

- Confirm the legality of the contribution; or
- Refund the contribution to the contributor and note the refund on the report covering the period in which the refund was made. 11 CFR §103.3(b)(1).

Facts and Analysis

The Audit staff reviewed contributions received by KRP and identified four contributions totaling \$52,498 from apparent corporate entities. The Audit staff verified with the Secretary of State that three of these entities were incorporated when the contributions (\$42,498) were made. These amounts were deposited into the account discussed in Finding 1 above used for national convention expenses that KRP did not consider to be a federal account. These contributions were to defray the cost of hotel rooms, breakfasts for the delegates and entertainment at the convention.

The one remaining contribution (\$10,000) was determined to be from a limited liability company, which may choose a corporate tax filing status. As such, the limited liability company was required to affirm to KRP that it was eligible to make the contribution based on its tax filing status being other than corporate. Records provided by KRP did not contain any such affirmations or any follow-up by KRP to verify eligibility.

The Audit staff presented this matter to a KRP representative during the exit conference along with a schedule of the apparent prohibited contributions. The KRP representative stated they would send a letter requesting the tax filing status for the limited liability company and would refund any remaining prohibited contributions.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that KRP provide documentation detailing the tax filing status for the contribution from the limited liability company and demonstrate that the remaining three contributions were made with permissible funds. Absent such evidence, it was recommended that KRP refund the \$52,498 to the contributors or transfer the funds to a non-federal account and provide documentation of such refunds (i.e., copies of each negotiated refund check, front and back) or transfer. If funds were not available, then the refunds or transfer due were to be disclosed on Schedule D (Debts and Obligations) until funds became available to make the refunds or transfer. In response to the interim audit report, KRP acknowledges that these contributions were received from corporations or companies taxed as a corporation and deposited into its Federal account rather than its non-federal account. KRP transferred \$15,000 on January 25, 2010, from its federal account to its non-federal in partial payment of prohibited contributions and also amended its most recent report to disclose the remaining obligation of \$37,498² on Schedule D as owed by KRP to its non-federal account.

² In its response, KRP noted a portion of a prohibited contribution had been refunded; however, the refund was made from its non-federal account. In amendments filed, KRP included this in the amount owed to its non-federal on Schedule D.

Finding 3. Payment of Federal Activity Out of Non-federal Accounts

Summary

KRP appeared to have improperly made payments totaling \$104,859 from its non-federal accounts for federal expenses. In response to the interim audit report, KRP amended its reports to disclose these disbursements paid from its non-federal account for federal/shared expenses.

Legal Standard

- A. Accounts for Federal and Non-federal Activity.** A party committee that finances political activity in connection with both federal and non-federal elections may establish two accounts (federal and non-federal) and allocate shared expenses—those that simultaneously support federal and non-federal election activity—between the two accounts. Alternatively, the committee may conduct both federal and non-federal activity from one bank account, considered a federal account. 11 CFR §102.5(a)(1)(i).
- B. Paying for Allocable Expenses.** Commission regulations offer party committees two ways to pay for allocable, shared federal/non-federal expenses.
 - They may pay the entire amount of the shared expense from the federal account and transfer funds from the non-federal account to the federal account to cover the non-federal share of that expense; or
 - They may establish a separate, federal allocation account into which the committee deposits funds from both its federal and non-federal accounts solely for the purpose of paying the allocable expenses for shared federal/non-federal activities. 11 CFR §106.7(f)(1)(i) and (ii).
- C. Reporting Allocable Expenses.** A state, district or local committee that allocates federal/non-federal expenses must report each disbursement it makes from its federal account (or separate allocation account) to pay for a shared federal/non-federal expense. Committees report these kinds of disbursements on Schedule H4 (Disbursements for Allocated Federal/NonFederal Activity). 11 CFR §104.17(b)(3).
- D. Allocation Ratio for Administrative & Non-Candidate Specific Voter Drive Costs.** State and local party committees must allocate their administrative expenses and non-candidate specific voter drive costs according to the fixed percentage ratio. Under this method, if a Presidential candidate and Senate candidate appear on the ballot, the committees must allocate at least 36% of expenses to their Federal funds. 11 CFR §106.7(d)(2)(ii) and (3)(ii).

Facts and Analysis

Distinct from the National Convention account addressed previously in Finding 1. Misstatement of Financial Activity, the Audit staff determined that KRP maintained four non-federal bank accounts. KRP made payments from two of its non-federal account totaling \$104,859 that should have been paid from a federal account. Most of these payments were for allocable administrative and non candidate specific voter drive expenses, which KRP should have paid from a federal account and reported on Schedule H-4 using the fixed percentage ratio of 36%

federal and 64% non-federal in accordance with 11 CFR §106.7(d)(2)(ii) and (3)(ii). Below is a breakdown of the \$104,859 in federal activity paid from the non-federal account:

Payment and Disclosure of Non Allocable Federal Election Activity (FEA)

A payment of \$1,639 was disbursed from one of the non-federal accounts for the purchase of convention pins³. It appeared KRP should have paid this expense from a federal account.

Payment and Disclosure of Lodging Expense

KRP paid \$5,000 from one of their non-federal accounts for lodging pertaining to the national party convention. This expense should have been paid from a federal account.

Payment and Disclosure of Allocable Administrative Costs

Apparent allocable administrative expenses totaling \$83,861 were disbursed from two non-federal accounts for postage, rent, consulting, travel reimbursements, printing, phone service and office supplies. Available documentation does not indicate that any of these payments were for solely non-federal activities; therefore, they are treated as allocable administrative expenses. The federal share for these expenses is \$30,190 (\$83,861 x 36% Federal share).

Payment and Disclosure of Printed Materials

KRP disbursed \$14,359 from a non-federal account for printed materials for which copies were not available to assess the nature of these expenditures. As such, the Audit staff could not verify that these expenditures were properly made from the non-federal account and were not required to be reported to the Commission. Should documentation be provided to indicate these expenditures are other than solely non-federal in nature, KRP should properly disclose these transactions.

The Audit staff compared reimbursements received from the non-federal account for its share of allocable activity. This analysis indicated the non-federal account could have reimbursed an additional amount that is in excess of the amounts at issue. Therefore, after considering all adjustments, it is concluded that there was no net funding of federal activity by the non-federal committee at the end of the two year audit period and only the disclosure issues need to be addressed by KRP.

At the exit conference, the Audit staff addressed these matters and provided schedules identifying the transactions noted above to a KRP representative. The KRP representative stated that they would in amended reports to include these as memo entries.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended KRP demonstrate that the identified disbursements paid from the non-federal account are solely non-federal expenses. As part of that demonstration KRP was requested to obtain and provide samples of the printed materials and a sample or description of the pin to demonstrate the nature of these expenditures. Absent such a demonstration, it was recommended that KRP amend its reports to disclose, as memo entries, the above noted

³ The Audit staff is unable to verify that this disbursement was properly made from a non-federal account. The purchase of the pins was in close proximity to the convention and other payments made to that vendor were for convention gifts. However, should a copy of the pin or a description of its content be provided indicating the nature of this expense to be allocable or solely non-federal, the Audit staff will revise its conclusion.

disbursements on Schedules B (Itemized Disbursements) or H-4 (Disbursements for Allocated Federal/Nonfederal Activity), as appropriate. In response to the interim audit report, KRP noted that due to scant records it is unable to demonstrate that these disbursements are for non-federal purposes. In light of the lack of records and that no non-federal overfunding occurred, KRP amended its reports to correctly disclose these disbursements.

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